Portfolioadvisor

The Tax-Savvy Investor

To the tax-savvy investor, it's not what you make before taxes – it's what you keep after taxes that really matters. Following are four rules for becoming a tax-savvy investor:

Rule #1: Understand how different investments are taxed

When evaluating an investment, consider how the income from that investment is taxed. Income from interest-bearing investments is fully taxable at your marginal rate, while Canadian dividends are effectively taxed lower due to the Dividend Tax Credit. Capital gains receive the most favourable tax treatment – only half of the gain is taxable.

Rule #2: Take advantage of tax-deferred growth

There are several ways you can benefit from tax-deferred growth, but one of the best ways is through your registered plans, such as your Registered Retirement Savings Plan (RSP). Because the investment income earned within your RSP is not taxed until it is actually withdrawn, your investments grow faster than they would outside your RSP.

Rule #3: Look beyond your registered plans

There are many other products and strategies that help you reduce the tax bite, including strategies such as low-turnover investment portfolios, which can reduce taxes by limiting the number of times you trigger taxable capital gains, and products such as tax-advantaged mutual funds.

Rule #4: Don't choose an investment solely for tax reasons

Just because a certain investment is taxed at a higher rate doesn't mean there isn't a role for it within a balanced investment portfolio. Evaluate investments based on several factors, including risk level, growth potential, liquidity and after-tax return.

Please contact us for more information on becoming a tax-savvy investor.

RBC Dominion Securities

Tax-savvy strategies

We all pay taxes. We may not like it, but there's not much we can do about it. While you can't completely avoid taxes, there are ways you can reduce them. Following are some key strategies to help you reduce the taxes you pay on your investment income.

Maximize your registered plans

Normally, the income you earn from your investments would be taxable in the year earned. But within a registered plan, such as a Registered Retirement Savings Plan (RSP) or Registered Retirement Income Fund (RIF), that income is sheltered from tax. Only when you start withdrawing income from your registered plan does it get taxed. This tax deferral can have a large impact on the growth of your investments.

You can also benefit from continued tax-deferred growth when you convert your RSP into a RIF. If possible, don't convert your RSP into a RIF until close to the final deadline – Dec. 31 of the year in which you turn 69 – in order to maximize your RSP's tax-deferred growth. Then, consider withdrawing only the minimum amount required from your RIF, leaving the remainder to continue growing on a tax-deferred basis, while drawing income from other sources.

Build a tax-savvy portfolio

Making the most of your registered plans is a good starting point for building a tax-savvy investment portfolio. But there are also strategies you can apply to your overall investment portfolio, including both your registered and non-registered accounts.

› Reduce portfolio turnover in your non-registered accounts. "Turnover" is simply the percentage of your investments that are sold and replaced with other investments in any given year. The higher the turnover, the more often you sell your investments. Within a non-registered account – which doesn't offer tax deferrals like a registered account – every time you sell an investment at a profit, you have to pay capital gains tax. However, by reducing the turnover in your non-registered account, you can also reduce the taxes you currently pay.

› Shelter interest-bearing investments. Interest income generated by GICs and bonds is fully taxable at your marginal rate, while both Canadian dividends and capital gains are taxed at a lower rate. Because of this, it can make sense to allocate more of your interest-bearing investments to your registered account, where they will be sheltered from taxes, while allocating more of your tax-efficient investments like Canadian dividend-paying stocks to your non-registered account.

Use capital gains and losses wisely

No one likes to lose money on an investment, but even for the smartest and luckiest investor, it does tend to happen now and again. When this happens to you, and you decide the investment no longer meets your needs and you sell it, you can use the capital loss to offset capital gains realized on the sale of other investments.

For example, say you sell an investment at a loss of $5,000, but you sell another investment for a gain of $15,000. You can use the $5,000 loss to reduce your net capital gain to $10,000 – and only half of that is taxable at your marginal rate. If you have more capital losses than gains in a given year, you can apply the losses against gains in the three previous years, or carry them forward indefinitely to apply against future capital gains.

Split income to reduce taxes

"Income splitting" is a strategy to reduce a married or common-law couple's future tax bill. Due to Canada's graduated tax rates, a couple with one higher income and one lower income generally pays more combined tax than a couple with two similar incomes. To even out their future income, the spouse expected to earn the higher income can contribute to a spousal RSP. The spouse making the contribution claims the tax deduction, but the other spouse eventually draws income from the RSP. New tax proposals may allow retirees aged 65+ to split up to half of their income from RIFs, pensions and annuities when reporting the income on their tax returns. While this does not replace the value of spousal RSPs, it is a potentially important additional income-splitting opportunity for seniors if the proposal is enacted.

Please contact us today to learn how tax-savvy investment strategies can benefit your portfolio.

Tax-savvy investments

Investment	Tax advantages	Considerations
Common shares	› Only 50% of any capital gain from the sale of common shares is taxable at your marginal rate. › Canadian common shares may pay dividends, which are taxed lower due to the Dividend Tax Credit.	› Common shares are not guaranteed and vary considerably in quality.
Corporate class mutual funds	› A corporate class mutual fund has several different classes, which you can switch between without triggering taxes. › Each class has different investment objectives — for example, one class might invest in U.S. equities, another in Canadian bonds, and so on. › Distributions may be taxed at favourable rates, even if you invest in bond or money market classes.	› Like all mutual funds, corporate class funds fluctuate in value. › Some corporate class funds with high portfolio turnover make more frequent taxable distributions, reducing or eliminating the tax advantages.
Flow-through shares	› Issued by resource companies, these shares “flow through” exploration and development expenses to investors who can then claim them as deductions. › These deductions, which are mostly available in the first year, can be very significant.	› Flow-through shares are typically very high risk. › With an adjusted cost base of zero, a taxable capital gain is near certain upon disposition.
Labour-Sponsored Funds (LSFs)	› LSFs provide a 30% tax credit to a maximum of $1,500.	› You have to repay the tax credit if you sell an LSF before the eight-year holding period. › LSFs tend to be higher risk.
Income trusts	› Some of the distributions from certain income trusts including some Real Estate Investment Trusts and Royalty Trusts can be tax-advantaged.	› Income trusts are not guaranteed, and values often fall when interest rates are rising. › Recent proposed changes to federal tax law would see the attractiveness of income trusts diminish over the next four years.
Tax-exempt life insurance	› Your deposits grow on a tax-deferred basis similar to a registered plan. › One portion of any deposit goes to the insurance premium on your life, while the rest goes to an investment pool. › You can arrange tax-free income with loans that are secured by the insurance policy as collateral, which are paid back with the proceeds after death.	› You need to factor in the insurance costs, which can vary depending on your age and health.

Contact our office for more information about tax-savvy investments.

Tax-savvy wealth protection strategies

Benjamin Franklin said there are two certainties in life – death and taxes. Unfortunately, death and taxes often go hand-in-hand.

After death, your estate may be left with some very hefty tax bills:

- Close to half of your registered plan, such as an RSP or RIF, may be payable to the government.
- Half of any capital gains automatically triggered on death are taxable.
- As much as 45% of the value of your U.S. property is payable to the U.S. government under U.S. Estate Tax rules.

To meet these tax obligations, your beneficiaries may have to liquidate certain assets that they would rather not – like treasured heirlooms or property that's been in the family for generations.

Fortunately, there are insurance-based strategies that can protect your estate, so you can leave your legacy intact.

1. RSP/RIF tax protection

Often, the top marginal tax rate is applied to all remaining funds in your RSP or RIF when they are taken into income in your final T-1 tax return, or that of your surviving spouse. On a $300,000 RIF account, close to $150,000 will be payable to the Canada Revenue Agency in taxes, depending on which province you live in. With a life insurance benefit, you can cover this tax obligation.

2. Capital gains tax protection

Your assets can be transferred at death to your spouse without triggering taxation. But on the death of your spouse, the government considers your assets to have been sold at fair market value – even if they haven't actually been sold. This can trigger taxable capital gains. Taxable assets include shares in private or publicly traded corporations, real estate other than your principal residence and family heirlooms such as art, jewelry and antiques. Life insurance can help your heirs retain these assets and avoid an untimely "fire sale".

3. Covering your U.S. Estate Tax

You could have a U.S. tax liability, even if you are a non-resident. If you are a Canadian resident who is not a U.S. citizen or green card holder, your estate may have to pay U.S. Estate Tax. Up to 45% of the value of your U.S. assets may be payable to the U.S. Internal Revenue Service. Depending on your circumstances, tax protector insurance may be the most cost-effective way to cover this liability.

You are exempt from this tax if:

1. Your U.S. assets are valued at US $60,000 or less at death.
2. Your worldwide assets at death are less than US $2 million, regardless of the value of your U.S. assets.

If your assets exceed these thresholds, your estate may be subject to U.S. Estate Tax.

Make sure you consult with a qualified tax advisor before implementing any tax strategies. Please contact us for more information.